Morgan Stanley

February 15, 2012

Technical Director
File Reference No. 2011-200
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Proposed Accounting Standards Update, Financial Services – Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements

Dear Technical Director:

Morgan Stanley appreciates the opportunity to comment on the Financial Accounting Standards Board’s ("FASB" or the "Board") Proposed Accounting Standards Update ("ASU") Financial Services – Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements (the "Proposed Update").

We have participated in the preparation of the responses to the Proposed Update submitted by the Securities Industry and Financial Markets Association ("SIFMA") Asset Management Group Accounting Committee and are generally supportive of the views expressed therein. We note that the International Accounting Standard Board’s ("IASB") exposure draft has been issued in parallel with the Proposed Update. We have submitted a comment letter on the IASB’s exposure draft ED/2011/A Investment Entities issued in August 2011 (the "IASB ED").

We note that the FASB has separately issued the Proposed Accounting Standards Update Real Estate - Investment Property Entities (Topic 973). We believe there should only be one standard that defines what an investment company is, and that single standard should apply irrespective of the type of investment it holds. We recommend that the Board not adopt the investment property entity ("IPE") model, but rather retain the model where entities that primarily hold investment property would be considered investment companies as defined under the Proposed Update. Please refer to our comment letter on the proposed update on investment property entities for further details on our views.

We appreciate the FASB’s efforts to work with the IASB to develop a common definition of an investment company entity. However, as mentioned in our comment letter to the IASB ED, while adoption of the Proposed Update and the IASB ED, as drafted, would reduce the existing differences in the accounting under IFRS and US GAAP for entities of this type, we are concerned that significant differences would remain. Areas of divergence include the two Boards’ differing approaches to consolidation of an investment company subsidiary by an investment company parent and retention of specialized investment company accounting on consolidation by a non-investment company parent. We support the adoption of a common approach to the accounting by investment companies/entities and urge the FASB and IASB to work to eliminate the remaining differences in their proposed approaches.
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As the Board re-deliberates the proposed guidance, we would appreciate it if our views are considered in finalizing a converged standard. Further detail is included in the responses to the questions raised in the invitation to comment in the attached Appendix.

- We strongly support the proposal in the Proposed Update that an entity which is determined to be an investment company should be required to measure its investments in those entities that it controls at fair value through profit or loss, as opposed to consolidating such entities.
- We disagree with the Board’s proposal that an investment company should consolidate another investment company in which it has a controlling financial interest and are specifically concerned about the impact of this on fund-of-fund structures.
- We agree with the Board’s proposal that a noninvestment company parent company should retain the specialized accounting of an investment company subsidiary because fair value is the most relevant measure for investment companies.
- While we generally agree with the criteria which the Board has identified for determining whether an entity is an investment company, we believe these factors should be considered in their totality in making that determination and that all six criteria do not necessarily need to be met in order to conclude that an entity is an investment company. In this context, we are most concerned about the “pooling-of-funds” criterion and the impact of this to entities with a single investor. We are also concerned with the requirement that the ownership interests held by investors in an investment company should be exclusively in the form of equity or partnership interests in the investment company.

We hope you find our feedback helpful. If there are any comments that are unclear, or you would like to discuss anything further, please do not hesitate to contact me at (212) 761-1136 or Dave Bonnar at (212) 276-7824.

Sincerely,

Peggy Capomaggi
Managing Director
Assistant Global Controller

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Appendix

Below are our detailed responses to certain of the questions raised in the invitation to comment.

**Question 1:** The proposed amendments would require an entity to meet all six of the criteria in paragraph 946-10-15-2 to qualify as an investment company. Should an entity be required to meet all six criteria, and do the criteria appropriately identify those entities that should be within the scope of Topic 946 for investment companies? If not, what changes or additional criteria would you propose and why?

We believe the Board has generally identified the appropriate factors for consideration in determining whether an entity is an investment company. However, we do not agree on an approach that requires satisfaction of all six criteria in order to make such a determination. We believe the application of professional judgment based on the relevant facts and circumstances, considering the application of those six criteria, is important to appropriately identify the population of entities that should qualify as investment companies. In particular, we are concerned that the Board has articulated the "pooling-of-funds" criterion in a manner that does not allow sufficient scope for the application of professional judgment. Our concerns in this area are described in more detail in our responses to Questions 7 and 9 below.

**Question 7:** To be an investment company, the proposed amendments would require an entity to have investors that are not related to the entity's parent (if there is a parent) and those investors, in aggregate, must hold a significant ownership interest in the entity. Is this criterion appropriate? If not, why?

As discussed in our response to Question 1, we are concerned that the requirement to have multiple investors that are unrelated to the entity's parent (if there is a parent) could have an unintended consequence of scoping out many funds that would otherwise fall into the definition of an investment company. It does not allow for the application of professional judgment and would preclude investment company classification for certain entities where this treatment would most appropriately reflect the substance of the entities' activities. The criterion, as drafted, would seem to preclude all entities with only a single investor from qualifying as an investment company. For example, this would impact entities with a single investor that have been established in contemplation of a related investment company which invests in a number of investments alongside another investment company (i.e., a co-investment vehicle). We believe that a co-investment structure should be appropriately accounted for as an investment company. The investor in such a vehicle requires fair value information regardless of the fact that it may be the only investor in the vehicle. We recommend that the Board modifies the "pooling-of-funds" criterion to allow for more judgment to be exercised in assessing whether single investor companies would qualify as an investment company assuming all other criteria are being assessed holistically to prevent any potential abuses. Our concerns in this area are also described in our response to Question 9.

**Question 8:** The proposed unit-ownership criterion would require an entity to have ownership interests in the form of equity or partnership interests to be an investment company. The entity
would consider only those interests in determining whether it meets the proposed pooling-of-funds criterion. Therefore, a securitization vehicle, such as a collateralized debt obligation, may not qualify as an investment company under the proposed amendments because it may not meet the unit-ownership or the pooling-of-funds criterion. The entity would not consider interests held by its debt holders when evaluating these criteria to be an investment company. For entities that do not have substantive equity interests (for example, those considered variable interest entities under Subtopic 810-10), should the unit-ownership and pooling-of-funds criteria to be an investment company consider interests held by debt holders? Please explain.

We do not agree with the requirement that the ownership interests held by investors in an investment company should be exclusively in the form of equity or partnership interests in the investment company. We believe that the relevant factor to consider is whether the units issued by the entity represent a specific portion of the net assets of the entity. The requirement that investors obtain equity or partnership ownership interest under the Proposed Update could give rise to an unnecessary level of complexity in evaluating whether the ownership interests satisfy the US GAAP definition of equity or partnership interests and whether the legal form equity is required to be classified as debt in accordance with relevant guidance under the current US GAAP. We note that such proposed requirement could result in a significant change in practice for collateralized debt obligations (CDOs) that currently employ investment company reporting. We also note there could be jurisdictions where funds will issue interests that are legal form debt, and that this should not prevent them from qualifying as an investment company to the extent that such accounting best reflects the substance of their operations and provides financial information which best meets the needs of users.

**Question 9:** Certain entities may meet all of the other criteria to be an investment company but have only a single investor (for example, a pension plan). The amendments in FASB’s Proposed Update on investment property entities provides that if the parent of an entity is required to measure its investments at fair value under U.S. GAAP or the parent entity is a not-for-profit entity under Topic 958 that measures its investments at fair value, the entity would not need to meet the unit-ownership and pooling-of-funds criteria to be an investment property entity. Considering the Board’s concerns identified in paragraph BC24, should the criteria in this proposed Update be amended to address situations in which the entity has a single investor?

We understand the Board’s concerns identified in paragraph BC 24 that an investment company could be inserted into a large corporate structure to achieve a particular accounting outcome. However, we believe the evaluation of the factors/indicators as a whole, are sufficiently robust to prevent significant potential abuses without requiring multiple external investors that are unrelated to the entity’s parent (if there is a parent). We recommend that the Board modify the “pooling-of-funds” criterion to allow for more judgment to be exercised in assessing whether single investor companies would qualify as investment companies as we discussed in our response to Question 7.

**Question 12:** The proposed amendments would retain the requirement that an investment company should not consolidate or apply the equity method for an interest in an operating company unless the operating entity provides services to the investment company. However, the...
proposed amendments would require an investment company to consolidate controlling financial interests in another investment company in a fund-of-funds structure. An investment company would not consolidate controlling financial interests in a master-feeder structure. Do you agree with this proposed requirement for fund-of-funds structures? If not, what method of accounting should be applied and why? Should a feeder fund also consolidate a controlling financial interest in a master fund? Please explain.

We strongly support the Board’s proposal that an entity which is determined to be an investment company should be required to measure its investments in those entities that it controls at fair value through profit or loss, as opposed to consolidating such entities. We believe that reporting investments at fair value provides the users of financial statements with the most useful information, given that the investments are held for capital appreciation, investment income or both, rather than for the management of the activities of the investee as part of the broader business of the consolidated group of which the investment company forms a part. Fair value accounting for the underlying investments also generally provides the basis for the net asset value at which many investors enter and exit their investment.

However, we disagree with the Board’s proposal that an investment company should consolidate another investment company in which it has a controlling interest. We note that this is an area of significant divergence from the IASB’s ED. We do not believe that consolidation of the controlled investee funds, where such a fund represents an investment for the purpose of obtaining returns from capital appreciation, investment income or both, results in information that is more decision-useful to investors. We believe that investment company investors are most concerned with the fair value of their fund’s investments, which directly drives the fund’s net asset value and the investor’s ownership interest and investment performance. We believe that reporting all investments, whether or not these investees meet the criteria for treatment as investment entities, at fair value provides the users of financial statements with the most useful information and that fair value is the most faithful representation of the relationship between the entity and its investees.

**Question 13:** The proposed amendments would require an investment company to consolidate a controlling financial interest in an investment property entity. Should an investment company be subject to the consolidation requirements for controlling financial interests in an investment property entity? If not, what method of accounting should be applied and why?

For the reasons discussed in Question 12 above, we similarly disagree with the Board’s proposal to require an investment company to consolidate a controlling interest in an IPE if the Board retains the notion of an IPE. We note that the FASB has separately issued the Proposed Accounting Standards Update Real Estate - Investment Property Entities (Topic 973). We believe there should only be one standard that defines what an investment company is, and that single standard should apply irrespective of the type of investment it holds. We recommend that the Board not adopt the IPE model, but rather retain the model where entities that primarily hold investment property would be considered investment companies as defined under the Proposed Update. Please refer to our comment letter on the proposed update on investment property entities for further details on our views.
Question 18: The proposed amendments would retain the current requirement in U.S. GAAP that a noninvestment company parent should retain the specialized accounting of an investment company subsidiary in consolidation. Do you agree that this requirement should be retained? If not, why?

Yes. We support the Board’s proposal to retain the investment company accounting on consolidation by a non-investment company parent. Consequently we disagree with the IASB’s opposing view, as expressed in our comment letter to the IASB. We believe that once an entity is deemed an investment company, fair value measurement for its investments is the most relevant accounting representation of its investments. Given that the business model for these investments will be the same at the level of the consolidated group, we believe that if fair value provides the most meaningful information for users of financial statements of investment companies then it will also provide the most meaningful information about those investments in the consolidated financial statements.

If the two Boards were to ratify their respective current proposals, a significant difference between US GAAP and IFRS will persist. This will undermine one of the principal objectives of issuing the Proposed Update and IASB ED to achieve convergence in this area. In our view, and taking account of the above discussion, there is no conceptual basis for retaining this disparity.